Dear Fellow Committee Members:

This is likely to be my last Letter as Chair. My two-year tenure is about to end and the very able Barbara Costello is slated to succeed me (In fact, Barbara is the subject of this edition’s Membership Spotlight). As I reflect back on these last few years, I am gratified to have witnessed the dynamic growth our Committee has experienced.

We have held regular monthly conference calls, which have been announced in advance on our LinkedIn page, with over 160 members, and on Twitter. Of course, both our LinkedIn page and Twitter account are open to all PODL Members, so if you haven’t yet done so, please join us. We have regularly convened in-person Committee sessions at our quarterly TIPS Meetings. We have also consistently contributed to the TIPS Annual Survey and sponsored several excellent programs each year that have been very relevant, informative, and highly acclaimed. I have been especially pleased to see new members, such as Carleton Burch and Greg Monaco, take the initiative to produce PODL programs without the direct involvement or prompting of senior committee members. A few of our programs have drawn large crowds, such as our two “Day at Lloyd’s” programs, that were held in New York in late January and early February and have attracted crowds of over 100 and 70 people respectively. We are also about to

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launch publication of our Global D&O Deskbook, written by authors from 28 different countries, many of the authors being PODL Committee Members.

What may be the most exciting new development is the introduction of our first Committee Newsletter with case notes written by our membership from various judicial circuits throughout the country. This is an initiative that began at the last ABA Annual Meeting, to ensure that our membership has the opportunity to stay current as to the most recent case law impacting the professional liability insurance practice, and has been successfully shepherded by our newsletter’s co-editors Janice Hugener and Dan Strick. It also gives young and new members an opportunity to contribute to our Committee’s work. I am happy to see it come to fruition.

As we close out this fiscal year, there are two outstanding Committee events that warrant your attendance. The first is our final webinar entitled: “Are We Related? A Look at Interrelationship Provisions in Claims-Made Policies.” Not only is it a very topical issue, we have also assembled an outstanding and diversified panel including: Carol Zacharias, representing the company side; Serge Adams, representing the broker side; Ommid Farashahi, representing insurance companies’ counsel; and Neil Posner, representing policy holders’ counsel, all to opine on the interplay of Claims-Made policies when one or more policy years are involved. It will be aired in the Fall. As the Moderator, I have had the privilege of participating in the creation of the power-point presentation, and can assure you that it is the best analysis of the Interrelationship issue I have ever come across. You will be able to register for this worthwhile event on line.

Thanks to David Benfield and John Hughes, we are also in the final stages of planning for our Fourth Annual PODL CLE and Reception, which will take place on August 8, 2014, running from 4:00PM to 5:00PM EDT, in Boston, Massachusetts. This year’s CLE will focus on, Boston’s own Charles Ponzi, the man for whom the term “Ponzi Scheme” was named; and the availability of Financial Institutions/Investment Advisors professional liability coverage. The CLE will be held at the law offices of Edwards Wildman & Palmer at 111 Huntington Avenue, located in the heart of the ABA Annual Meeting festivities. A PODL reception will follow at the trendy POST 390 Urban Tavern, located at 406 Stuart Street, a short walk from the law firm. Both the CLE and reception is complementary, and all PODL members are invited to attend. RSVP to podlreception@kbrlaw.com. For anyone interested, after the reception, we plan hold an informal group dinner at a local eatery. I hope to see you on August 8, in Boston, where I can personally thank you for your support of PODL, and you can wish our new Chair, Barbara Costello, your best.

In the meantime, I thank you for all of your support and you outstanding participation, which has transformed our Committee into one of the most active and innovative Committees within the Tort Trial and Insurance Practice Section of the ABA.

Sincerely,
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MEMBER SPOTLIGHT

Barbara Costello

The PODL member spotlight this issue focuses on PODL’s incoming Chair, Barbara Costello. Barbara is a Partner in the New York City office of the national law firm, Kaufman Borgeest & Ryan LLP. Barbara’s practice focuses on the representation of insurers in coverage matters in the areas of directors’ and officers’ liability, employment practices liability and fiduciary liability. Her practice also includes the drafting of insurance policies and counseling insurers regarding management liabilities and underwriting considerations relevant to insuring those liabilities.

Barbara has authored multiple articles and lectured nationally on multiple topics involving D&O liability, employment practices liability and insurance coverage litigation. She has also been elected a Fellow of the American Bar Foundation, an honorary organization of lawyers, judges, and legal scholars whose public and private careers have demonstrated outstanding dedication to the highest principles of the legal profession. Membership in The Fellows is limited to less than one percent of lawyers licensed to practice in each jurisdiction.

Barbara has been a member of PODL since 2006. As a member of PODL, Barbara has had the opportunity to participate as a cle speaker at the ABA Annual Meeting and in TIPS webinars. She has also contributed to the PODL newsletter, the TIPS Law Journal and The Brief. She is looking forward to working with our active and enthusiastic committee to continue to ensure that PODL remains the preeminent forum for networking, leadership and professional development opportunities for practitioners in the areas of professional and D&O liability.

If you would like to become more involved in one of the many programs, publications and networking events PODL is planning for the coming year, Barbara may be contacted at bcostello@kbrlaw.com.

If anyone wishes to learn more about joining either Twitter or LinkedIn and how to follow PODL, please contact Ari R. Magedoff, Esq., Claims Specialist, AXIS Insurance, ari.magedoff@axiscaptial.com.

On Twitter we can be found at @ABATIPSPODL.

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THE SECOND CIRCUIT CONFIRMS
THE SEC’S ABILITY TO SETTLE
WITHOUT REQUIRING ADMISSIONS OF
WRONGDOING

By: Angelo Savino and Megan Whitehill

In November 2011, Judge Jed Rakoff of the Southern District of New York ignited a firestorm of commentary and concern among the securities bar by declining to approve a settlement between the SEC and Citigroup in which the bank neither admitted nor denied the alleged wrongdoing. Several other district judges subsequently followed Judge Rakoff’s lead, and the SEC eventually adopted a new policy to require admissions of wrongdoing as a condition to settlement in certain cases. These events appeared to cast doubt on the future ability of parties to enter into the traditional “neither admit nor deny” type of settlement with the SEC and thus posed significant challenges to parties willing to settle actions by the SEC.

On June 4, 2014, however, the U.S. Court of Appeals for the 2nd Circuit reversed Judge Rakoff’s opinion in SEC v. Citigroup Global Markets Inc., holding that the judge had abused his discretion by applying an incorrect legal standard in analyzing the consent decree and setting a trial date. In doing so, the Circuit Court emphasized that a District Court must defer to the SEC’s discretion with respect to structuring consent judgments.

Background

By way of background, the SEC filed a complaint against Citigroup in October 2011, claiming that Citigroup had negligently misrepresented its role and economic interest in structuring and marketing a billion dollar fund, in violation of Sections 17(a)(2) and (3) of the Securities Act of 1933. The SEC claimed that Citigroup had exercised significant influence over the selection of $500 million worth of the fund’s assets — primarily collateralized by subprime securities tied to the U.S. housing market. According to the SEC, Citigroup had itself selected a substantial amount of negatively projected mortgage-backed assets in which Citigroup had taken a short position, while telling investors that the fund’s portfolio was chosen by an independent investment advisor. Citigroup reaped roughly $160 million in profits from the poor performance of its chosen assets, while fund investors lost millions.

After filing the complaint, the SEC filed a proposed consent judgment in which Citigroup agreed to a permanent injunction barring Citigroup from violating Sections 17(a)(2) and (3), disgorgement of $160 million, prejudgment interest, and a civil penalty of $95 million. Citigroup also agreed to refrain from seeking an offset against any compensatory damages awarded in a subsequent investor action and consented to make internal changes designed to prevent similar acts from recurring. The decree contained no admission of guilt or liability. The SEC also filed a parallel complaint against Citigroup employee Brian Stoker alleging Stoker negligently violated Sections 17(a)(2) and (3).

The District Court scheduled a hearing on the matter, presenting the SEC and Citigroup with numerous questions. Judge Rakoff subsequently issued a written opinion on November 28, 2011, refusing to approve the consent judgment. He noted that the proposed consent decree “is neither fair, nor reasonable, nor adequate, nor in the public interest … because it does not provide the Court with a sufficient evidentiary basis to know whether the requested relief is justified under any of these standards.” S.E.C. v. Citigroup Global Markets Inc., 827 F. Supp. 2d 328, 332 (S.D.N.Y. 2011). Judge Rakoff criticized the consent decree because it did not measure up to settlements obtained in other cases. Declining to approve the consent judgment, the District Court consolidated the case with the Brian Stoker action and ordered the parties to be ready to try both cases on July 16, 2012. The S.E.C. and Citigroup immediately filed notices of appeal.

The 2nd Circuit Decision

In its June 4, 2014 opinion, the 2nd Circuit reversed. It first concluded that it had jurisdiction to consider the

Continued on page 16
THE JUMPSTART OUR BUSINESS
STARTUPS (JOBS) ACT: AN OVERVIEW
OF THE ACT AND ITS POTENTIAL IMPACT
ON THE PROFESSIONAL LIABILITY
INSURANCE INDUSTRY

By: Fiona McCormack, Esq., Associate1 and Edward Carleton, Esq.,
Associate2, Boundas, Skarzynski, Walsh & Black, LLC

The Jump Start Our Business Start-Ups (“JOBS”) Act was signed into law by President Obama on April 5, 2012, after being passed by an overwhelming majority of both houses of Congress. The Act consists of measures (broken up into seven titles) intended to open up access to capital and investments for entrepreneurs, relatively small companies and start-ups, with the ultimate goal of increasing job creation in the U.S.

In the approximately two years since the JOBS Act’s passage, legislators and commentators have deliberated on its potential impact on the U.S. economy as a whole, as well as on individual investors and discrete industries, including the fields of securities law and professional liability insurance. Many people have high hopes for the Act as a breakthrough that will afford small business owners a better chance of success and allow more ordinary Americans to invest directly in small companies and, ultimately, foster innovation and growth. As President Obama put it in his Rose Garden speech about the Act on April 5, 2012:

[F]or start-ups and small businesses, this bill is a potential game changer. Right now, you can only turn to a limited group of investors – including banks and wealthy individuals – to get funding... Because of this bill, start-ups and small business will now have access to a big, new pool of potential investors – namely, the American people. For the first time, ordinary Americans will be able to go online and invest in entrepreneurs that they believe in.

On the other hand, many experts and commentators fear the JOBS Act will create new opportunities for fraud on unsophisticated investors and weaken measures enacted to protect investors in recent years, such as the Sarbanes-Oxley (“SOX”) Act of 2002. Former Securities and Exchange Commission Chairman Mary Schapiro noted her concerns about the Act’s potential erosion of investor protections in a letter she wrote to the U.S. Senate Committee on Banking, Housing, and Urban Affairs in March 2012, before the Act’s implementation. She wrote, “While I recognize that H.R. 3606 is the product of a bipartisan effort designed to facilitate capital formation and includes certain promising approaches, I believe that there are provisions that should be added or modified to improve investor protections.” In a different forum and a different tone, former New York Attorney General and governor, Eliot Spitzer, wrote in a March 2012 article for Slate that the JOBS Act “should in fact be called the “Return Fraud to Wall Street in One Easy Step Act.”

While there are arguably good reasons for the hopes and fears on both sides of the debate, the JOBS Act has not yet been fully implemented, and its full impact on investors, business owners and job creation therefore remains to be seen. This article will focus on what we know about the Act’s effects to date, as well as potential claims that could arise under the Act and potentially impact professional liability insurers. The article will also provide a general overview of the Act’s provisions, organized by title.

The JOBS Act: An Overview

The JOBS Act applies to a new category of companies known as “emerging growth” companies (“EGCs”) (i.e., companies with annual gross revenues of up to $1 billion), and puts measures into place intended to...
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COVERAGE IMPLICATIONS FOR FALSE CLAIMS ACT LITIGATIONS UNDER PROFESSIONAL, MANAGEMENT AND EMPLOYMENT PRACTICES LIABILITY POLICIES.

By: Melinda B. Margolies*

Liability insurers of all lines and perils, from Marine to Directors and Officers, have been presented with notifications from insureds who are seeking coverage for defense and indemnity for lawsuits brought pursuant to the False Claims Act (“FCA”). 31 U.S.C. § 3729, et seq. The FCA, as well as similar state laws, allows governments to recoup money from recipients of government funds who have presented false claims for payment. Id. FCA complaints can range from allegations of traditional fraud to seemingly less fraudulent allegations about the failure of corporations to meet the government’s expectations for services or products, such as poor nursing home care, poor information technology services, or billing for drug prescriptions for off-label uses. See, e.g., Health Care Industry Liability Ins. Program v. Momence Meadows Nursing Center, 566 F.3d 689 (7th Cir. 2009); United States ex rel. Bergman v. Abbott Laboratories, 2014 WL 348583 (E.D. Pa. January 30, 2014); Information Systems and Network Corporation, et al. v. Federal Ins. Co., 805 A.2d 1141 (Md. App. 2002). Even charitable corporations and their directors and officers have faced FCA litigation for alleged failure to keep accurate records of employee time spent on projects funded by government grants. See, U.S. ex rel. Simmie Brown v. Board of Directors of Delta Foundation, et al., 2001 WL 34153991 (5th Cir. October 19, 2001). While FCA litigation most commonly exists in the medical- or drug-related fields of industry, it can arise in any context where the government is footing the bill.

The disparate nature of the suits involved, coupled with the dissimilar policy forms and policy wordings at issue in insurance coverage matters, has resulted in a conflicting, and sometimes confounding, body of insurance coverage case law under professional, employment, directors, officers and management liability policies. Coupled with this lack of congruent guiding precedent is the complicating fact that the stakes in FCA cases can be very high,1 making coverage disputes and court-ordered coverage determinations of keen interest to the insurance bar. Insurance coverage cases in state and federal courts repeatedly tackle coverage issues presented by FCA litigations, including insuring agreement triggers, interrelatedness of Government litigation and employee whistleblower claims, the determination of the date of claim, and numerous types of exclusions and coverage limitations that potentially apply to defense and indemnity of FCA lawsuits.

False Claims Act and Qui Tam Litigations: Procedure, Proof and Relief2

The fact that FCA cases can spawn disagreements over insurance coverage is based in part on the fact that FCA litigation usually does not follow the course of traditional litigation, but rather, in many instances, FCA cases begin with the filing of a complaint under seal, which is not served on defendants. See, e.g., H.R. Acquistion I Corp., f.k.a. Capstone Capital Corp. v. Twin City Fire Ins. Co., 547 F.3d 1309 (11th Cir. 2008); AmerisourceBergen, 2013 WL 3868784 at 7. The FCA allows for both direct actions by the Attorney General and qui tam actions, which can be filed by ‘whistleblowers’ or ‘informers’, known as relators, who in turn receive a portion of any recovery. 31 U.S.C. §§ 3730 (a) and (b). By operation of statute, qui tam suits are filed with the court under seal for 60 days to allow the Attorney General to investigate or decline involvement. Id. §3730(b)(4). During the time the complaint is filed under seal, the Government investigates, may serve Civil Investigative Demands, and may seek extensions from the court to continue the investigation with the Complaint under seal. Id. §§ 3730(a)(b)(2)-(4) and §3733. FCA lawsuits

Continued on page 22

* Melinda B. Margolies is a partner at the law firm of Kaufman, Borgeest & Ryan LLP representing insurers in coverage matters. She focuses on professional and corporate liability insurance, including, employment, directors and officers, errors and omissions, and management liability policies. KBR has offices in New York City, Westchester, Long Island, New Jersey, Connecticut and California. Ms. Margolies can be contacted at mmargolies@kbrlaw.com.


2 Qui Tam is the abbreviated legal Latin phrase “Qui tam pro domino rege quam pro se ipso in hac parte sequitur” meaning “He who brings a case on behalf of our lord the King, as well as for himself.” BLACK’S LAW DICTIONARY, 1251 (6th Ed. 1990).
ENFORCEABILITY OF A PERSONAL JURISDICTION/FORUM SELECTION CLAUSE AGAINST AN EMPLOYEE’S NEW EMPLOYER IN A NON-COMPETE DISPUTE: Where the Law Stands in the Second Circuit, and Generally Applicable Lessons Nationwide

By: Peter J. Biging and Joanne J. Romero

I. Introduction

A company hires an employee from a competitor, and immediately becomes embroiled in litigation over whether the employee is violating the non-compete provisions of his employment agreement. While the employee does not reside in New York, his employment agreement with the past employer contains a forum selection provision pursuant to which he has agreed to litigate any dispute arising therefrom in the former employer’s home state. Seizing on this, the former employer brings suit against the employee in its home state, even though the former employee does not reside or work there now, and works for his new employer in a completely different region of the country. Nothing surprising about this, and all pretty straightforward. However, the twist comes when the former employer also argues that this provision subjects the new employer to the court’s personal jurisdiction as well, even though the new employer has no offices in the state, does virtually no business there, and has never signed anything purporting to evidence its consent to the jurisdiction of the state over it. Does this argument have any merit? While one might think the answer should be a simple “no”, in fact, the answer is not so simple.

A recent federal court decision in New York addressed this issue, and so doing highlighted the fact that there is no definitive ruling yet on the issue in the Second Circuit, nor much caselaw relevant to this specific issue overall. This article will explain the test that appears to govern consideration of what circumstances under which a non-signatory to a contract with a forum selection clause can potentially end up being subjected to personal jurisdiction based thereon, examine the test that has been applied and the reasoning behind it, attempt to predict how the Second Circuit may ultimately rule on the use of such provisions to subject non-signatories to a court’s in personam jurisdiction, and discuss lessons that may be applicable generally in other circuits with regard to this issue.

II. The “Closely Related” Test and Personal Jurisdiction Over Non-Signatories

In CA, Inc. v. Stonebranch, Inc.,2 Plaintiff, CA, Inc., sought to pursue breach of contract and other claims against a former employee who had moved to Stonebranch, Inc. CA contended that the employee had breached the non-competition provisions of his employment agreement with CA by assisting Stonebranch in its successful bid for work with a municipality in Ohio that CA lost out on. Although the former employee did not reside or work in New York and there was no provision in the agreement whereby he specifically consented to the exercise of personal jurisdiction over him by the New York courts, CA argued that the forum selection provisions of his employment agreement subjected him to New York’s in personam jurisdiction with regard to litigations concerning his employment agreement.3 The forum selection clause provided that any action relating to the agreement or employee’s employment was to be brought pursuant to which he has agreed to litigate any dispute arising therefrom in the former employer’s home state.

Continued on page 28

1 Peter J. Biging is a partner with Goldberg Segalla, LLP, and Joanne Romero is an associate with the firm. Both Peter and Joanne practice out of the firm’s New York City offices.
Second Circuit
By: Seth B. Goldberg

Claims By Investors Against Bank’s Former Directors Are Not Covered As “Interrelated Wrongful Acts”


In Glascoff, the Court concluded that a bank’s professional liability insurer did not breach its policy by denying coverage for a claim filed by several individual investors, after the policy’s expiration date, against the bank’s former directors (hereinafter, “the insureds”).

The insureds had argued that the claim was covered, because it was based upon the same purported “Interrelated Wrongful Acts,” as a prior claim asserted against them by the FDIC, during the policy period, for which the insurer was providing coverage. The FDIC claim alleges, in sum and substance, that the insureds, through their negligence and breach of certain fiduciary duties, caused or contributed to the failure of the bank, and the bank’s resulting $50.7 million loss. The latter claim, asserted by the individual investors, seeks to hold the insureds liable for alleged misrepresentations made by the bank’s former CEO to the investors relative to certain specific investment opportunities.

The Court ultimately concluded that the two claims do not arise out of the same “Interrelated Wrongful Acts,” as defined under the policy, because they do not share a sufficient factual nexus — i.e., the two claims do not share parties, legal theories, or requests for relief. The Court also explained that the mere fact that both claims generally allege a “lack of oversight” by the insureds in connection with their operation of the bank does not establish a sufficient nexus between the two claims for purposes of coverage under the policy. The Court therefore dismissed the declaratory judgment action against the insurer.

Dishonest Acts and Public Policy Exclusions May Not Preclude Coverage For Settlements Relative to Insured’s Deceptive Market and Trading Activities


Bear Stearns commenced an insurance coverage action seeking a declaration that its professional liability insurers are obligated to indemnify it for losses arising out of its settlement of SEC and NYSE administrative proceedings, and related civil class action lawsuits, predicated on allegations that Bear Stearns facilitated its customers’ deceptive market timing and late trading activities. The Court in that case granted Bear Stearns’ partial motion for summary judgment, and dismissed the insurers’ affirmative defenses based upon the dishonest acts and public policy exclusions. The Court concluded, in particular, that “the settlements embodied in the Administrative Orders are not final adjudications or judgments establishing Bear Stearns’ guilt in the underlying proceedings that it engaged in the wrongful conduct covered by the Dishonest Act Exclusion.” For essentially the same reason, the Court also rejected the insurers’ affirmative defense that the “findings contained in the Administrative Orders conclusively establish that . . . coverage is barred under New York public policy.”

The Court noted, however, that the action continues “with respect to assessing whether there is evidence demonstrating Bear Stearns ‘had the requisite intent to cause harm,’ and if the disgorgement payment to the SEC is linked to ‘improperly acquired funds,’ which would bar insurance coverage on public policy grounds.”

Former Priest Not Entitled to Coverage For “Counseling Incident” Under Prior Acts Endorsement


Plaintiff, a former priest, initiated a declaratory judgment action against his insurer for coverage in connection with a parishioner’s underlying claims against him. In the
underlying action, the parishioner alleged that the priest – who counseled the parishioner to accept his wife’s decision to divorce – had an irreconcilable conflict of interest in providing such marriage counselling, because the priest was having an affair with the parishioner’s wife.

In the coverage action, the plaintiff alleges that the underlying claims are covered as a “counseling incident” under the “Counseling Professional Liability” provision contained in the insurer’s policy. The insurer thereafter moved for summary judgment claiming that the alleged “counseling incident” took place before the policy period, and is excluded from the “Prior Acts Coverage Endorsement” because the plaintiff had knowledge of the incident before the “Prior Acts Date” stated therein of July 1, 2010. The Court ultimately granted the insurer’s motion, as the alleged “counseling incident” undisputedly took place before the inception date of the policy, and the plaintiff admitted that he had knowledge of the incident, as early as May of 2009, when the parishioner informed the plaintiff that he had learned of the affair. The record also revealed that the plaintiff informed his supervisors at the Church about the affair, and the parishioner’s discovery of it, before the “Prior Acts Date” stated in the policy. The Court, therefore, concluded that the plaintiff was not entitled to coverage under the insurer’s policy, for the parishioner’s underlying claims.

Sixth Circuit

By: W. Joel Vander Vliet

Damages in the Form of Money Unlawfully Retained Not Excluded as Disgorgement


Nurses filed an antitrust class action against plaintiff, William Beaumont Hospital, and other Detroit-area hospitals, alleging, inter alia, that the hospitals exchanged compensation information with each other, which had the effect of depressing wages. Beaumont sought coverage under an Executive Protection Policy issued by Federal Insurance Company. Federal agreed to pay 80% of Beaumont’s defense costs (the “covered percentage” under the policy for antitrust claims) subject to a reservation of its right to seek reimbursement. Beaumont then filed a coverage action against Federal seeking a declaration that Federal was obligated to indemnify it. While the coverage action was pending, Beaumont settled the underlying litigation for $11.3 million. Federal paid 80% ($9 million) of the settlement amount, reserving its right to reimbursement. In the coverage action, Federal argued that the settlement payment was not covered because it constituted disgorgement. The policy’s definition of “Loss” provided: “Solely with respect to any Claim based upon, arising from or in consequence of profit, remuneration or advantage to which an Insured was not legally entitled, the term Loss . . . shall not include disgorgement by any Insured or any amount reimbursed by any Insured Person.”

Crediting Beaumont’s argument that “money unlawfully retained is not the same in its legal character as money unlawfully acquired,” and noting that “Federal used the term restitution elsewhere in the Policy, so it should be aware of the difference between the two terms, [restitution and disgorgement]” the Sixth Circuit held that the settlement represented allegedly unpaid wages retained by Beaumont, not amounts obtained or acquired by Beaumont. Accordingly, the settlement payment was not disgorgement. In so ruling, the panel distinguished cases like Level 3 Communications, Inc. v. Federal Ins. Co., 272 F.3d 908 (7th Cir. 2001) (holding that relief labeled as damages was “restitutionary in nature” and thus uninsurable), on the grounds that Level 3 and its progeny all involved the allegedly wrongful acquisition of something other than the mere retention of amounts owed.

Conversion of Data Constitutes Rendering of or Failure to Render Research-Related Services under Clinical Research Professional Liability Policy


Plaintiff, Medpace, Inc., was accused of conversion for refusing to turn over to its client certain data and

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information generated in clinical trials. Darwin refused to defend Medpace under a clinical research professional liability insurance policy, taking the position that Medpace’s failure to turn over the data had nothing to do with the rendering of or failure to render professional services. Instead, Darwin argued, it was merely an attempt “to force a former client into paying its fees” at a time when the professional relationship with the client had ended. Rejecting Darwin’s arguments that the claim had to arise during the performance of professional services and could not be covered after the client had terminated the professional relationship, the court held that Medpace’s failure to deliver the data to its former client was covered as a failure to render professional services, and Darwin, therefore, owed Medpace a duty to defend.

Seventh Circuit

By: Ommid Farashahi and Whitney Ross

By Statute in Wisconsin, Notice-Prejudice Rule Applies to Claims-Made-and-Reported Policies


Thomas Aul, an attorney, represented Melissa and Kenneth Anderson in the purchase of real estate. The Andersons became dissatisfied with Aul’s representation and retained independent counsel. On December 23, 2009, the Andersons’ counsel wrote a letter to Aul describing the Andersons’ dissatisfaction with Aul’s legal representation and demanding payment of $117,125. Aul retained counsel to respond to the claim.

Wisconsin Lawyers Mutual Insurance Company (“WLM”) issued a claims-made-and-reported professional liability policy to Aul for the period April 1, 2009 to April 1, 2010. Under the terms of the policy, failure to send a written report of a claim within the policy period was conclusively deemed prejudicial to WLM.

Aul provided notice of the December 23, 2009 letter to WLM on March 9, 2011, 11 months after the end of the policy period. The Andersons filed suit against Aul on March 2, 2012 for legal malpractice. On March 22, 2012, WLM agreed to defend Aul under a reservation of rights, but intervened and moved for summary judgment, arguing that the claim was not timely reported. The Circuit Court concluded that coverage was not available under the policy because the December 23, 2009 letter constituted a claim, and Aul did not timely notify WLM of the claim during the policy period. Aul appealed the Circuit Court’s ruling.

In reversing the Circuit Court’s ruling, the Wisconsin Court of Appeals held that policy terms are not the only provisions dictating how the timeliness of notice affects coverage. The Court held that, under Wis. Stat. §631.81, which applies to insurance contracts generally, there is a presumption of no prejudice if notice was given within a year of the policy’s requirement. The Court held that, under §632.26(2), which explicitly applies to every liability insurance policy, if notice was not given as required by the policy, the burden shifts to the insured to show there was no prejudice to the insurer. While WLM argued that the policy is a claims-made-and-reported policy, the Court held that Wis. Stat. §631.81 and §632.26 do not contain an exception for such policies. The Court held that a breach of the insurance contract arising from late notice, or notice not given as soon as reasonably possible, must be material and prejudicial to the insurer vis-à-vis the particular claim for coverage. The Court concluded that the insurer did not meet its burden of proving prejudice, i.e., a serious impairment of the insurer’s ability to investigate, evaluate, or settle a claim, determine coverage, or present an effective defense resulting from an unexcused delay, where the insurer’s sole argument was that the delay would require WLM to pay a claim for which it did not bargain.

Under Indiana Law, No Coverage for Claim Not Made And Reported During Same Policy Period


Margaret Ditteon was the owner of Personal Resource Management (“PRM”), a business providing

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guardianship services to the elderly. In 2008, Ditteon discovered that the case manager assigned to the Charles Mitchell Estate had embezzled from Mitchell’s guardianship. Ditteon subsequently applied for insurance through Evanston Insurance Company (“Evanston”). In the application, Ditteon did not disclose the potential claim by Mitchell. Evanston then issued a claims-made-and-reported professional liability insurance policy to PRM for the period July 15, 2009 to July 15, 2010 (the “2009 Policy”). Evanston issued a policy with similar terms to PRM for the July 15, 2010 to July 15, 2011 policy period (the “2010 Policy”).

Between October 13, 2010 and February 24, 2011, PRM tendered to Evanston various complaints filed by the Mitchell Estate against PRM related to the mishandling of Mitchell’s assets. Evanston issued denial letters for all of the Mitchell claims. PRM then filed a lawsuit against Evanston alleging breach of contract and bad faith. In response, Evanston sought a declaration that it owed no coverage to PRM. On summary judgment, the trial court ruled in favor of Evanston finding that the lawsuits did not fall within the scope of coverage, and PRM failed to timely notify Evanston of the claims. PRM appealed the trial court’s ruling.

The Indiana Court of Appeals affirmed the trial court’s ruling. The Court stated that PRM submitted the Mitchell claims between October 13, 2010 and February 24, 2011 – after the expiration of the 2009 Policy and the 60-day extended reporting period. The Court held that the Policy requires that claims be reported during the policy period or extended reporting period, and none of the three claims submitted under the 2009 Policy were timely.

Additionally, the Court held that the 2010 Policy included a retroactive effective date of July 15, 2009, and each of the Mitchell claims tendered to Evanston included allegations of malfeasance by PRM prior to the effective date. The Court held that, as a matter of law, the alleged conduct did not occur within the policy period and was not subject to coverage under the 2010 Policy. The Court then considered the generalized allegations of undated conduct and determined that PRM’s acts did not continue into the policy period of the 2010 Policy. The Court concluded that, for each undated allegation of misconduct, the original wrongful act occurred when PRM performed deficiently, or failed to perform in a timely fashion, before the 2010 Policy. The Court held that, as a matter of law, the undated generalized allegations of wrongful acts are not covered by the 2010 Policy.

**Under Illinois Law, Services Provided by Insured to Affiliate Constitute “Professional Services”**


The insured, Hilco Trading LLC (“Hilco”), had several subsidiaries, including Hilco Appraisal (“Appraisal”) and Hilco Valuation (“Valuation”). Appraisal and Valuation provided expert valuation of assets. Hilco separate owned Hilco Financial, LLC (“Financial”), which made loans to other companies through asset-based lending. Hilco, Appraisal, and Valuation were insured under a professional liability insurance policy issued by Liberty Surplus Insurance Corporation (“Liberty”) for errors in rendering “professional services,” defined to mean services “provided by the Insured to a third party for a monetary fee.”

On March 31, 2010, the Patriot Group, LLC (“Patriot”) filed a complaint against Appraisal, Valuation, and Financial. Financial had obtained funding from Patriot to issue loans to third parties, but Financial later defaulted on the Patriot loan. As a condition of loan approval, Financial was required to provide Patriot with appraisal and audit reports showing the third party loans were fully secured. Appraisal and Valuation appraised the assets for Financial which secured the Patriot loan. Patriot alleged that Appraisal and Valuation performed appraisals that were grossly inflated with the knowledge that they would be forwarded to Patriot. On May 20, 2010, Bayerische Hypo-und Vereinsbank AG (“BHV”) filed a similar complaint against the insureds alleging similar wrongdoing in connection with loan agreements between Financial and BHV.

The lawsuits were tendered to Liberty. Hilco sought a declaratory judgment that Liberty was obligated to defend both actions. Liberty filed a motion for summary judgment, arguing that it had no duty to defend because the policy only covers professional services provided to a third party for a fee, not services provided by Appraisal and Valuation to Financial. The trial court agreed with Liberty, holding that Patriot and BHV were not third parties that commissioned the services of Appraisal and Valuation. The insureds appealed the ruling.

The Illinois Appellate Court reversed the trial court’s ruling. The Court held that all parties agreed that Appraisal and Valuation knew the appraisals would be
used to induce Patriot and BHV to provide loans before the appraisals were delivered to Financial, and that Appraisal and Valuation provided their written consent for Patriot to use the appraisals. Based upon these facts, the Court ruled that the appraisal services and reports were arguably provided to a third party, therefore triggering Liberty’s duty to defend.

Ninth Circuit

By: Charles Slyngstad

“Adverse Domination” Doctrine Rejected by the Ninth Circuit As Being Inconsistent with the “Sole Actor” Rule

USACM Liquidating Trust v. Deloitte & Touche, __ F.3d __ (9th Cir. 2014), No. 11-15626, as am. Jun. 6, 2014, ___ 2014 WL 2535468.

A bankruptcy litigation trust pursued claims against the underlying debtor’s former outside auditor. The trust alleged the auditor wrongly issued unqualified audit opinions for fiscal years 2000 and 2001 that concealed misappropriations of the debtor’s funds by the owners and controllers of the debtor, leading to its bankruptcy filing in 2006. The auditor asserted that the claims were time-barred, while the trust argued for concealment-based tolling of limitations based on the “adverse interest” exception, which precludes general imputation of an agent’s acts to the principal corporation when the agent’s actions are completely and totally adverse to the corporation.

Applying recent Nevada law, the court found that the “sole actor” rule, a limited exception to the adverse interest exception, imputed the agent’s knowledge to the corporation when the agent and corporation are indistinguishable from each other. The court found requisite ownership and control and did not see any evidence of an innocent decision-maker within the debtor. Concealment-based tolling thus did not apply. The Ninth Circuit also concluded that Nevada had not and would not adopt the “adverse domination” doctrine, which tolls claims against a corporation controlled by wrongful actors until the actors are no longer in control. The premise of the doctrine, according to the court, is inconsistent with Nevada’s sole actor rule, so the Ninth Circuit concluded Nevada would not adopt it.

The lesson for creditors of audited Nevada corporations is to read the narrative of the audited financial statements where the auditors describe ownership and control of the organization.

Clients Own Their Legal Matters In The Context Of A Law Firm Bankruptcy Action


In a decision sure to be headed to the Ninth Circuit, the Northern District of California granted summary judgment against creditors in the bankruptcy case of the Heller Ehrman LLP law firm, disagreeing with a decision to the contrary by the Bankruptcy Court. The court stated that “neither law, equity, nor policy recognizes a law firm’s property interest in hourly fee matters,” and thus creditors of the law firm may not claw back profits on such unfinished matters from third-party law firms that continued or completed the work begun at the debtor law firm. The decision emphasized that clients “own” their legal matters, a position taken by the ABA in an amicus brief filed in May 2014 in the Coudert Brothers LLP bankruptcy case in New York. The court also distinguished for various reasons an intermediate appellate court decision in California, Jewel v. Boxer, including because of subsequent changes in the Revised Uniform Partnership Act. The “unfinished business” when Heller Ehrman filed for bankruptcy involved hourly work, not contingency cases.

Arizona Recognized Fiduciary Exception To the Attorney-Client Privilege


The intermediate appellate court in Arizona recognized the fiduciary exception to the attorney-client privilege, an exception that Arizona had not previously recognized. A trustee that sought legal advice on matters of trust administration from trust counsel using trust funds could not withhold any of its attorney-client communications from the beneficiary or the successor trustee. But the court held that the “trustee’s attorney-

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client privilege vis-à-vis a beneficiary extends to all legal advice sought in the trustee’s personal capacity for purposes of self-protection,” even if trust funds are used to pay the lawyers or the same attorneys advise the trustee on matters of trust administrations or self-protection. (The court side-stepped the attorney conflict issue because it was not required to decide whether the trustee required independent counsel.)

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**THE SECOND CIRCUIT...**

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interlocutory appeal because the District Court’s order threatened irreparable harm: the order prevented the SEC from obtaining an injunction barring Citigroup from violating the Act in the future and requiring Citigroup to take steps to prevent future acts of fraud.

The Circuit Court then determined that the District Court had abused its discretion in refusing to approve the consent decree. The court recognized that while a district judge is not merely a “rubber stamp,” a district court is required to enter an order if it determines that the proposed consent decree is fair and reasonable and that the “public interest would not be disserved” — no adequacy inquiry is appropriate. S.E.C. v. Citigroup Global Markets, Inc., Docket Nos. 11-52227-cv (L); 11-5375-cv(con), 11-5242-cv(xap) (2d Cir. June 4, 2014).

The Circuit Court continued by explaining that a court evaluating a proposed SEC consent decree for fairness and reasonableness should assess “1) the basic legality of the decree, 2) whether the terms of the decree, including its enforcement mechanism, are clear, 3) whether the consent decree reflects a resolution of the actual claims in the complaint, and 4) whether the consent decree is tainted by improper collusion or corruption of some kind.” Id. (internal citations omitted). Emphasizing the deference a district court must afford the SEC, the court cautioned that a district court must take care “not to infringe on the S.E.C’s discretionary authority to settle on a particular set of terms.” Id. at p. 21

Thus, the 2nd Circuit reasoned, Judge Rakoff had abused his discretion in requiring that the SEC establish the truth of the allegations against a settling party as a condition for approving the consent decree. It noted that “[t]rials are primarily about the truth. Consent decrees are primarily about pragmatism.” Id. As such, it was not within the district court’s purview to demand “cold, hard, solid facts, established either by admissions or by trials” regarding the truth of the allegations as a prerequisite for approving a consent decree. Id. at p. 22.

Here, the Circuit Court continued, Judge Rakoff likely had a sufficient record before him on which to determine if the proposed decree was fair and reasonable. The job of determining whether the proposed consent decree best serves public interest “rests squarely with the S.E.C., and its decision merits significant deference.” Id. at p. 25. While the district court may consider the public interest, the district court may not find the public interest disserved “based on its disagreement with the S.E.C.’s decisions on discretionary matters of policy, such as deciding to settle without requiring an admission of liability.” Id. at p. 26. Moreover, Judge Rakoff’s withholding approval of the consent decree because he believed that the SEC failed to bring proper charges against Citigroup constituted an abuse of discretion. The SEC enjoys the exclusive right to choose which charges to levy against a defendant.

Accordingly, the 2nd Circuit vacated Judge Rakoff’s November 28, 2011 order and remanded the case for further proceedings in accordance with the opinion.

**Conclusion**

The 2nd Circuit’s decision restores a long-used, highly effective settlement tool to the tool box of the SEC and defense counsel. The SEC may well continue to press for admissions as a condition of settling in certain cases in accordance with its new policy and out of concerns to avoid appearing too soft on certain defendants. Nevertheless, in light of the 2nd Circuit’s decision, the SEC need not hesitate to agree to the “neither admit nor deny” formulation out of fear that courts will refuse to approve such settlements. Moreover, the decision should provide defense counsel with a stronger hand in refusing to accede to demands for admissions during the negotiation process, placing them in a better position to hold out for the neither admit nor deny formulation.

The continued viability of neither admit nor deny settlements should also ease the concerns of defendants and their insurers about heightened exposure in follow-on private litigation caused by admissions in SEC settlements.
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decrease costs to ECGs associated with going public, registering securities with the Securities and Exchange Commission (“SEC” or “Commission”), and making required disclosures to investors.

In summary:

- The Act permits ECGs to conduct initial public offerings (IPOs) while exempting them for up to five years from certain otherwise-applicable financial reporting and governance requirements. (The eased restrictions for IPOs are often referred to as the “IPO on-ramp” provisions, and are set forth in Title I of the Act.)

- It also relaxes restrictions on advertising and solicitation for private offerings, in Title II of the Act.

- The Act provides for statutory crowdfunding (in Title III), which will allow an ECG to raise up to $1 million annually by soliciting relatively small equity investments from a large number of investors without having to register the shares with the SEC.

- It increases from $5 million to $50 million the amount of capital that can be raised in a public offering without triggering full registration and periodic reporting obligations or mandatory compliance with state blue-sky laws (Title IV).

- Title V of the Act raises the maximum number of shareholders that trigger registration requirements for non-banks or bank holding companies from 500 to 2,000, as long as fewer than 500 are not “accredited investors” (as defined by the SEC).

- Finally, Title VI of the Act raises the maximum number of shareholders that trigger registration requirements for banks and bank holding companies from 500 to 2,000, and permits banks and bank holding companies to de-register a security if the number of record holders for it falls below 1,200 persons (as opposed to the former threshold of 300).³

Certain of the JOBS Act’s provisions have been in force since its April 2012 enactment: namely, the IPO on-ramp provisions set forth in Title I and the increased maximum number of shareholders that trigger registration requirements under Titles V and VI. Other provisions have been in effect since September 2013 (i.e., the eased restrictions on advertising and solicitation for private offerings set forth in Title II). Still others are not yet in effect (the crowdfunding provisions of Title III and the Title IV provisions increasing amount of capital that can be raised without triggering certain registration and reporting obligations), and are still in the SEC rulemaking process.

The Impact of the JOBS Act So Far

Since the enactment of the JOBS Act, the number of IPOs in the U.S. has steadily increased, reversing a trend of decreasing IPOs that had begun in 2000. In 2013, 222 IPOs were priced, compared to 125 IPOs in 2011, and 128 in 2012. In the first two quarters of 2014 alone, 134 IPOs were conducted – more than in any first-two quarter periods in the U.S. since 1999.⁴ Studies also show that, unsurprisingly, virtually all companies that qualify as ECGs and have conducted an IPO since the Act’s implementation have taken advantage of one or more of the Act’s IPO on-ramp provisions.

On the other hand, a recent poll by the data and research firm Prequin indicates that some private equity firms have been hesitant to date to take advantage of the Act’s general solicitation provisions. The firms polled cited high costs and negative perceptions associated with general solicitations, as well as concerns about conflicts with foreign securities laws, including the Alternative Investment Fund Managers Directive (“AIFMD”), a legislative initiative by the European Commission that governs hedge funds and private equity funds marketed in the European Economic Area (the EU, Iceland, Liechtenstein and Norway) and sets forth strict requirements for marketing to investors.⁵ Time will tell if these concerns will ultimately curb general solicitations under the Act.

The Act’s Provisions

Taken one by one, the main titles of the JOBS Act are as follows:

³ Title VII of the Act, which requires the SEC to conduct outreach and provide information about the JOBS Act to small and medium-sized businesses and businesses owned by women, veterans and minorities, is not discussed in this article.
⁴ Source: Renaissance Capital
⁵ Source: Prequin, Private Equity Spotlight - Volume 10 - Issue 5, May 2014
**Title I (Effective April 5, 2012) – the IPO On-Ramp:**

As noted above, Title I is already in effect, and provides for an easier IPO “on ramp” for ECGs within the first five years after the IPO, by scaling-down disclosure requirements, exempting ECGs from certain provisions of SOX and the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), and easing certain restrictions on research and issuer communications with accredited investors. First, Title I requires that an issuer provide only two years of audited financial statements – rather than the three years traditionally required— in its registration statement. It also exempts ECGs from requirements under Section 404(b) of SOX that an issuer provide an auditor attestation report on internal controls with its registration statement. It further exempts ECGs from the requirements in Section 951 of the Dodd-Frank Act that an issuer hold shareholder advisory votes on executive compensation and on golden parachutes (“Say on Pay” and “Say on Parachute” votes), and the requirement under Section 953 of the Dodd-Frank Act that issuers disclose executives’ compensation to investors. ECGs may also opt to be exempt under Title I from compliance with any new or revised financial accounting standards adopted or revised on or after April 5, 2012, until non-public companies are required to comply with such standards.6

Also under Title I, ECGs whose common equity securities have not been previously sold pursuant to an effective registration statement under the Securities Act of 1933 may confidentially submit a draft registration statement to the SEC for nonpublic initial review, as long as the registration statement is filed publicly at least 21 days before the start of the road show. This provision allows an ECG to shield its registration statement from public scrutiny while it determines whether to proceed with the IPO, and allows for any issues or problems with the statement to be initially worked out with the SEC before the registration becomes public.

Title I also permits an ECG to gauge investor interest (“test the waters”) before filing a registration statement by communicating with institutional accredited investors about the IPO prior to filing the registration statement. Finally, Title I allows analysts to publish research reports about an EGC, even if their employers are participating in an offering of the EGC’s securities, although the relationship must be disclosed.

With respect to potential claims arising from Title I of the JOBS Act, it is possible that the eased reporting requirements, such as the exemption from auditor attestation reports on internal controls required under SOX, will lead to shareholder suits and regulatory investigations arising from allegedly weak internal controls, potentially exposing D&O insurers. The provision allowing issuers to “test the waters” with institutional accredited investors could also lead to suits alleging misrepresentations.

Further, the rule permitting analysts to publish research reports about an EGC even if their employers are participating in an offering of the EGC’s securities could lead to charges of conflicts of interest created by the analyst’s motivation to garner business for his/her investment bank employer by issuing favorable research – similar to the claims that gave rise to multiple regulatory enforcement actions against brokerage firms during the “dot-com” boom and subsequent bust in the late 1990s and early 2000s, and the $1.4 billion “Global Analyst Research Settlement” in 2003, which involved 10 investment banking firms that together paid approximately $1.435 billion to regulators and investors who had been harmed.7

**Title II – Advertising and Solicitation for Private Securities Offerings (Effective September 2013)**

JOBS Act Title II took effect on September 23, 2013, and relaxes restrictions on advertising and solicitation for private securities offerings. As a general rule, entities seeking to raise capital in U.S. markets through the issuance of securities must register those securities with the SEC unless they qualify for an exemption. However, many exemptions from registration include a prohibition on advertising – the exempted entity may not seek to broadcast the offering through media sources, whether traditional print advertising or internet based advertising.

The JOBS Act Title II directed the Commission to amend the most commonly relied upon registration exemption, Rule 506 of Regulation D of the Securities Act of 1933, “Exemption for Limited Offers and Sales

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6 An ECG may elect to “opt in” and be subject to such accounting standards at the time they become applicable to public companies. An ECC’s election to opt in must be made on an all-or-nothing basis, and may not be revoked later.

7 In April 2003, ten investment banking firms settled charges by the SEC, the National Association of Securities Dealers (now the Financial Industry Regulatory Authority (FINRA)), the New York Stock Exchange and the New York State Attorney General that research analysts at the firms had a practice of recommending that investors buy or hold the stocks of companies that were the firms’ investment banking clients in order to generate business, even where the analysts doubted that the stocks were good investments. That settlement is often referred to as the Global Analyst Research Settlement.
Without Regard to Dollar Amount of Offering,” to allow for “general solicitation” in connection with Rule 506 offerings. Accordingly, the SEC implemented Rule 506(c), which permits ECGs to conduct offerings to an unlimited number of “accredited investors” and up to 35 non-accredited investors. The JOBS Act directs the Commission to remove the general restriction on solicitation to make it easier for start-ups to locate potential investors and raise necessary capital.

In July 2013, the amended rule was adopted by the SEC as Rule 506(c). Rule 506(c), which became effective on September 23, 2013, now allows issuers to advertise non-registered offerings. The new rule requires, however, that those issuers taking advantage of the solicitation provision take steps to verify that the targeted investors and ultimate purchasers are accredited under one or more SEC rules. New Rule 506 provides that reasonable steps for verifying investor accreditation could include review of IRS tax filings and/or a written confirmation from a broker dealer or licensed attorney.

With respect Title II and amended Rule 506’s implications for professional liability coverage, it is still too early to fully gauge the potential for claims arising out of “general solicitation” for unregistered offerings. Indeed, one survey of private equity managers in 2013 found that only 5% of the 150 respondents had conducted general solicitations under the new rule.

However, it is not difficult to conceive of the types of claims that could arise, for instance, in a Rule 506(c) offering where a participating investor was not accredited, but was nevertheless allowed to participate and ultimately incurred a financial loss, potentially triggering claims of rescission by all participating investors. In addition, lawyers, investment advisers and accountants could face liability for failure to “take reasonable steps” to verify accredited investor status, potentially exposing E&O policies.

**Title III – Crowdfunding (Not Yet Effective)**

Crowdfunding is the moniker given to the raising of capital through non-traditional means in order to fund entrepreneurial endeavors. Arguably, the most famous crowdfunding related company is Kickstarter, which operates an online platform for individuals seeking to raise funding for projects of all species, from small businesses such as bars and restaurants, to the all-time largest reported crowdfunding startup, the over $17 million raised by Cloud Imperium Games to develop the videogame “Star Citizen.” To date, crowdfunding has not involved the issuance of securities, which, absent exemption, would trigger registration obligations under the federal securities laws.

Title III of the JOBS Act creates a regulatory structure to assist smaller entities in using crowdfunding to raise capital – and help drive the engines of small business – without running afoul of the federal securities laws. Under Title III, the SEC is to write rules to essentially allow crowdfunded securities issues, subject to certain capital ceilings and other limitations, without having to register the transactions with the Commission. The SEC has written proposed rules, which are currently posted for public comment.

Under the proposed rules currently posted for public comment, companies would be limited to raising an aggregate of $1 million in a 12 month period. Investors in crowdfunded enterprises would be able to contribute up to $2,000 or 5% of their annual income or net worth, if both their annual income and net worth are less than $100,000. For investors whose income is greater than $100,000, investors would be able to contribute up to 10% of their annual income, up to a maximum aggregate investment of $100,000. Some entities, including foreign companies and companies that are currently SEC-registered and reporting, would not be eligible for the proposed crowdfunding registration exemption.

Under the proposed rules, companies raising capital through crowdfunding would not be entirely beyond the Commission’s oversight, however, as they will be subject to certain reporting requirements. Mandated disclosures, if the rules are adopted, would include information about directors and officers and control persons (persons owning 20% or more of the company seeking crowdfunding), descriptions of the company’s business model, certain related party transactions, and financial statements that would be included with the company’s tax returns.

One interesting component of Title III is that it requires that crowdfunding platforms – e.g., Kickstarter – be SEC registered. That is, such entities would be required to be either a broker-dealer or an SEC-registered funding portal. These intermediaries would be required to offer certain investor-protections, including providing information about crowdfunding offerings and taking measures to prevent or reduce fraud. Intermediary

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8 Investors meeting certain income or net worth requirements established by the SEC. Under Rule 501, accredited investors include individuals with net worth in excess of $1 million or have annual income in excess of $200,000.
funding portals would be prohibited, however, from providing investment advice or making recommendations with respect to individual crowdfunding issues.

Because the SEC’s proposed rules have not yet take effect, it is difficult to ascertain the potential for crowdfunding-related D&O and E&O claims. Given the nature of such funding, however, i.e., that it would be limited to small businesses raising limited amounts of capital, the principal risk will likely be borne by the small company D&O and E&O markets. As with most forms of deregulation there is an associated risk of fraud and abuse which could lead to claims by aggrieved investors that they were misled either by the company’s raising capital via crowdfunding, or, perhaps the greater risk to small and midmarket D&O and E&O carriers, claims against the yet-to-be-established “funding platforms,” including the requirement that they provide information to investors and take certain measures to prevent or reduce fraud.

Title IV: (Reg. A+) (Not Yet Effective)

Under Title IV of the JOBS Act (which is still in the rulemaking stage), an ECG will be able to increase a public offering of securities from $5 million to $50 million (raised within a 12-month period) without triggering full disclosure and reporting obligations, and without being subject to state blue sky laws, which are often onerous and costly to comply with – as long as the securities are offered or sold only to qualified purchasers (as determined by the SEC) or sold on a national securities exchange. Issuers will also be able to solicit interest in an offering before filing an offering statement, and securities issued in these offerings will be freely tradable.

Title IV is built upon an already existing exemption from the registration requirements mandated by the Securities Act of 1933: Regulation A, which has long been applicable to small public offerings of securities from $5 million or less raised in any 12-month period. Regulation A already permits an issuer to file a “mini-registration” with the SEC that allows for relatively reduced disclosures to investors, including the ability to submit “reviewed” financial statements rather than audited financial statements. Regulation A also allows the sale of securities to both accredited and unaccredited investors. The catch is that Regulation A offerings must comply with the state blue sky law requirements in each state where funds are solicited. The high cost associated with such compliance has been noted as a deterrent to small businesses that would otherwise benefit from utilization of Regulation A. By lifting the requirement that issuers comply with blue sky laws and lifting the maximum amount that can be raised to $50 million, Title IV – often referred to as “Regulation A+” – will likely be an appealing option for ECGs.

While disclosure requirements will be scaled-down for issuers under Title IV, issuers will still be required to file annual audited financial statements with the SEC and make certain periodic non-financial disclosures available to investors. Subsequent periodic reports and annual audited financial statements will also be required to be filed, and as noted above, the securities must be offered or sold only to qualified purchasers (as determined by the SEC) or sold on a national securities exchange.

Anti-fraud measures have not been relaxed for Title IV offerings and, given the high ($50 million) ceiling for these offerings, Title IV has the potential to give rise to high-exposure claims under both D&O and E&O policies. Potential claims arising out of Title IV include Rule 10b-5 suits and SEC investigations against issuers and auditors arising from statements in subsequent periodic reports and audited financial statements, and potential SEC actions and follow-on shareholder suits arising out of alleged sales to non-qualified purchasers. Some insurers will likely consider excluding claims arising under Title IV, or, alternatively, offering policies with a sublimit or a higher retention applicable to such claims.

Titles V and VI (Effective April 5, 2012) – Increased Shareholder Thresholds for Mandatory Registration/Reporting

Titles V and VI of the JOBS Act (which are fully in effect) amend Section 12(g) and Section 15(d) of the Securities Exchange Act of 1934. Prior to the enactment of the JOBS Act, Section 12(g) of the Exchange Act required companies with more than $10 million in assets and a class of equity securities held by 500 or more holders to register that class of securities with the SEC, thereby becoming subject to various reporting and other requirements. Section 15(d), in turn, required a company that registered securities for public sale under the Securities Act but did not meet the registration requirements of Section 12(b) or 12(g) of the Exchange Act, to file certain periodic reports for at least the first fiscal year in which its Securities Act registration statement was effective.

Now, under Title V, a company (other than a bank or a bank holding company) can increase the number of its
shareholders of record from 500 to 2,000 before it must register its securities or file periodic reports, as long as fewer than 500 of its investors are non-accredited). In calculating the number of holders of record, issuers may exclude certain holders who received the securities pursuant to an employee compensation plan, as well as shareholders that hold shares under a “street name,” and “crowd-funded” shareholders.

Title VI applies to banks and bank holding companies. Similarly to Title V, it permits a bank or a bank holding company to increase the number of its shareholders of record from 500 to 2,000 before it must register its securities or file periodic reports. Unlike Title V, however, Title VI does not impose a requirement for a maximum number of non-accredited investors. Title VI also permits a bank or a bank holding company to deregister any registered securities (thereby freeing itself of reporting requirements with respect to those securities) if the number of record holders for the securities falls below 1,200 persons. (The threshold is 300 for non-banks and bank holding companies.)

Anti-fraud laws, including Rule 10b-5, continue to apply to offerings and sales by these companies. Therefore, potential claims arising out of Titles V and VI could include regulatory actions and follow-on shareholder suits alleging fraud or errors in calculating the number of shareholders of record and accredited investors for purposes of the Act, and related securities class actions. While Titles V and VI were created to lower costs to ECGs, they may therefore increase ECGs’ record-keeping expenses related to counting shareholders of record, and could give rise to potential suits against these issuers.

Conclusion

The JOBS Act is still a work in progress. Titles III and IV have not yet been enacted, and the SEC has received thousands of comments from individuals and entities about them in the rulemaking process. While it will be some time before we know the full impact of this legislation on the U.S. economy, two things are certain: First, given its roll-backs of certain disclosure and registration requirements, even for large offerings, the Act could give rise to many different types of large securities and investment adviser claims, potentially exposing both D&O and E&O insurers and giving rise to new JOBS Act-related policy endorsements, exclusions, retentions, separate coverages, and/or sublimits.

Second, if it is implemented, developed, and enforced in a way that considers its impact on real people, the Act certainly has the potential to fulfill its ultimate goals of increasing jobs and fostering innovation and prosperity in the U.S.
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may be filed up to six years from the date of violation or three to ten years from the date of discovery of the violation. Id. § 3731.

The elements of an FCA case sound in knowing falsehood and fraud. See, id. §§ 3729 (a)(1)(A) and (B). Plaintiffs must show that 1) defendants submitted a claim for payment by the Government; 2) the claim itself or the record supporting the claim was false or fraudulent; and 3) the defendant knew the claim was false or fraudulent. See, e.g., U.S. ex rel. Pervez v. Beth Israel Med. Ctr., 736 F.Supp.2d 804, 811 (S.D.N.Y. 2010). Section 31 U.S.C. §3729(a)(1)(G) allows a reverse FCA claim, where defendants allegedly knowingly concealed or failed to remit an obligation owed to the Government. See, e.g., U.S. ex rel. Lisack v. Sakura Global Markets, Inc., 377 F.3d 145, 152 (2d Cir. 2004).

The relief allowed under the FCA involving claims for Government recovery includes actual damages, treble damages, per violation penalties up to $11,000. 31 U.S.C. §3279(a)(1), which can be reduced where defendants self-report or cooperate per §3729(a)(2). Relators receive 15-25% of any recovery where the defendants self-report or cooperate per §3729(a)(2). The Court reasoned that the poor medical care, horizon west's alleged failure to provide the professional care given to its patients, while the FCA Claim was replete with allegations of alleged professional misconduct as to the rendering or failing to render “professional services” as defined in the policy, such as a policy providing coverage for “professional nursing or medical services.” O’Hara, 529 F.3d at 921. Courts analyzing coverage and the duty to defend owed for FCA Claims under PL policies, almost universally find that an FCA Claim does not present a covered claim even where such litigations rely on allegations of professional misconduct to support the alleged falsity of the claims for funds. See, e.g., Momence, 566 F.3d 695 (FCA liability is based solely on the false claims presented to the government and not on shoddy patient care such that PL insurance provides no duty to defend); O’Hara, 529 F.3d at 921-922 (FCA injury is based on false claim not on subcontractor’s failure to comply with contractually agreed levels of nursing care); Horizon West, 45 Fed.Appx. at 753-754 (medical billing procedures are not a professional medical service provided by a nursing home).

For Professional Errors and Omissions Liability Policies (“PL” or “E&O” policies), triggering coverage under the insuring agreement often turns on whether the Claim submitted for insurance alleges misconduct as to the rendering or failing to render “professional services” as defined in the policy, such as a policy providing coverage for “professional nursing or medical services.” O’Hara, 529 F.3d at 921.

In Horizon West, 45 Fed.Appx. at 753, the Court was presented with the Insured’s argument that a medical professional liability policy should provide a duty to defend to the Insured in connection with an FCA Claim because the “injury to the United States (overpayment on Medicare and Medicaid claims) [resulted from] Horizon West’s alleged failure to provide the professional care services for which it billed the government” i.e. Horizon West allegedly rendered very little and very poor care to its patients. While the FCA Claim was replete with allegations of alleged professional misfeasance in the medical care given by Horizon West to its clients, the Court concluded that the liability under the FCA faced by the Insured did not result from “professional services” as required for policy coverage, but rather, the FCA Claim arose from the false billing. Id. 45 Fed.Appx. at 754. The Court reasoned that the poor medical care,
absent claims for Medicare and Medicaid payments, would have created zero possibility of FCA liability, and likewise, the inverse also existed, a false claim, whether or not premised on poor medical care, could result in FCA liability for Horizon West citing to §3729(a) of the FCA. *Id.*

Courts reaching similar conclusions that FCA Claims are not within coverage provided by professional liability policies have drawn distinctions between the elements of proof of an FCA Claim as contrasted with professional negligence claims. In *Jenkins, M.D. v. St. Paul Fire & Marine Ins. Co.*, 8 Fed.Appx. at 574, the Eighth Circuit found no duty to defend for Dr. Jenkins because FCA recovery was based on whether Dr. Jenkins “knowingly submitted false claims…for reimbursement…Accordingly any award…would not have resulted from…professional services.” In *O’Hara*, 529 F.Supp. at 921-922, the Court held no duty to defend an FCA Claim under three policies providing for medical incident coverage reasoning as follows: “The government’s injury was not caused by O’Hara’s failure to provide professional services, but instead resulted from O’Hara’s submission of false and fraudulent claims for reimbursement.” *Id.* Similar reasoning found no potentiality of coverage and no duty to defend a *qui tam* suit where extensive medical malpractice allegations were included in the complaint. *Momence*, 566 F.3d at 694. The Seventh Circuit reasoned: “Although the allegations in the underlying complaint detailing the injuries suffered by [nursing home] residents put a human touch on the otherwise administrative act of false billing, they need not be proven by the plaintiffs to prevail.” *Id.* Citing to *Momence*, the Court in *Ismie Mutual Ins. Co. v. Michaelis Jackson & Assoc’s, LLC*, 921 N.E.2d 1156, 1163 (Ill. App. 5th Dist. 2009) held that there was no duty to defend an FCA Claim premised on performance of unnecessary cataract surgeries because the “proof required to sustain a claim for personal injuries, like a medical malpractice claim, is clearly distinct from the proof required for a claim for false filings of claims for medical reimbursement.” *Id.* at 1164. In sum, there is a line of PL coverage cases involving FCA Claims which clearly conclude:

…an insurer is not obligated to defend a *qui tam* suit merely because the insurer would have to defend the insured against a suit for damages resulting from the insured’s conduct underlying the *qui tam* action. *Momence*, 566 F.3d at 695, string citation omitted.

Insurance coverage cases involving professional liability policies also delve into whether billing and administrative-type work is a contemplated professional service under the policy generally. *Horizon West*, 45 Fed.Appx. at 754. Many hold that “the bill is an effect of the services provided not part of the service itself.” *Id.* citing *Medical Records Assoc’s*, 142 F.3d at 516. In the case of *Medical Records Assoc’s, id. at 516*, the Court was presented with a more refined question than whether billing by a medical doctor or medical practice was a professional service. *Id.* Rather, the question presented in *Medical Records Assoc’s* was whether overcharging for copying medical records would present a claim for professional services where the term “professional services” was defined to mean “Medical Records Processor.” *Id.* at 514. Arguably, the Court could have concluded that the type of profession of “Medical Records Processor” could have contemplated billing and setting prices for copying services as professional services under the policy, but the Court rejected that argument reasoning that “…setting a price for services and sending bills are functions of every business, and not ones inherent in the processing of medical records.” *Id.* at 517. The Court suggested that the analysis of whether alleged harmful conduct in a Claim qualified as a professional service under a PL policy could entail a spectrum analysis of the types of activities alleged, and the Court compared the example of an ambulance company getting lost on the way to an accident as being closer on the spectrum toward professional services than setting the price of photocopies. *Id.* Similarly, in *MSO Washington, Inc. v. RSUI Group, Inc.*, 2013 WL 1914482, 1, 8 (W.D. Wash. May 8, 2013), the Court agreed that there was no duty to defend or indemnify the Insured under a PL policy where professional services were defined as “Physician Practice/Management Services.” *Id.* at 6. The Court adhered to the *Horizon West* line of cases concluding that “billing services are not covered professional services…” *Id.* at 8.

In contrast, in certain cases, some types of ministerial activity are considered part of the professional services. *See, Bayley Construction v. Great American E&S Ins. Co.*, 2013 WL 5913424, 4 (W.D. Wash. November 1, 2013). In *Bayley, id.*, the Court found a duty to defend a Construction Manager under a miscellaneous E&O Policy for failure to ensure that the prevailing wage was paid to all subcontractors on a government construction project. *Id.* at 6. The Court found that wage setting was an allegation involving a professional service as contemplated. *Id.* at 5-6. Great American argued that
the setting of wages was not a “professional service” as contemplated in the E&O Coverage provided to Bayley for “Construction Management, Pre-Construction Consulting Services and Design Services.” Id. at 5. In rejecting the insurer’s arguments, the Court held that under the duty to defend analysis, the policy must be interpreted broadly with any doubts resolved in favor of Bayley and thus, the duty to defend was triggered. Id. at 6. The Court also made a point to distinguish an entire line of FCA Claims such as Horizon West, supra., in reaching this conclusion. Id.

Similarly, in General Star Nat’l Ins. Co. v. Adams Valuation Corp., 2014 WL 4797591, 5-6 (N.D. Ill. February 6, 2014), the Court was urged to reach the conclusion that a Real Estate E&O Policy would provide a duty to defend an FCA Claim relating to the Insured’s alleged submission of false mortgage appraisal materials to the FDIC. The Insured urged the Court to distinguish cases like Momence, supra., because unlike a nursing home billing case, where the false statements to the government relate to the quality of professional services, in the case of alleged real estate appraisal rigging, the false statements are the professional services provided in real estate transactions. Id. Instead of providing an answer on the question of whether FCA coverage would be provided under E&O Policies where the alleged false statement is part and parcel of the professional service, the Court side-stepped the issue by finding coverage was excluded by the policy’s dishonesty exclusion. Id. at 6. This same argument would seemingly apply to other cases where professional liability policies are limited to negligence and would not extend coverage to an Insured who allegedly “knowingly” made false claims.

**General Commercial, Commercial Excess and Marine Policies**

Some guiding principles for FCA Claims appear to be present in the professional liability context, but again, certain of the above-discussed cases hinge on various wordings of professional services and how a policy describes the connection of professional services to the relief sought. It is worth mentioning here, that the above-mentioned reasoning for not covering FCA Claims has extended over to other types of policy wordings. For example, in the case of a government IT contractor making alleged misrepresentations to procure a contract to install a new automated access control system, no coverage was found under Commercial General Liability (“CGL”) and Commercial Excess and Umbrella Policies because a qui tam suit does not constitute a Property Damage Claim as required for coverage under the Policies. Information Systems and Network Corp. v. Federal Ins. Co., 805 A.2d. 1141, 1146-1147 (Md. App. 2002). Likewise a qui tam suit against a missile contractor did not trigger coverage under a policy providing products liability and property damage coverage because the FCA Claim did not involve damage to property but rather sought damages based on the billing for non-conforming missile parts in the Insured’s contract with the U.S. Government. Hercules, 776 A.2d at 563. The Court’s reasoning follows the professional liability line of cases above, stating:

> [there is a] fundamental difference between products liability and negligence on the one hand and the federal False Claims Act on the other hand. The federal False Claims Act is not aimed at breach of contract or property damage…to recover under the Act it is not even necessary to establish any damage. The Act carries its own penalty provisions. The Act is not a negligence or products liability variant. The Act is about fraud against the government.

Additionally, even outside of the context of professional lines coverage, Courts recognize that the Insureds cannot bootstrap FCA Claims to alleged underlying misconduct or injury for the purpose of attempting to trigger insurance coverage. See, M/G Transport, 234 F.3d at 978. The no bootstrapping rule is articulated as the basis for allowing no coverage for an FCA Claim under a Marine and Pollution Liability Policy issued to M/G Transport Services, where the Sixth Circuit held:

> An FCA action is not converted into a Clean Water Act action simply because a violation of the Clean Water Act is a predicate to establishing the falsity of a claim, or may be used as a measure of damages under the FCA. Id.

Thus, in many instances, courts turn a wary eye toward Insureds seeking FCA Claim coverage under policies that are not written to respond to government fraud claims.

**EPL and D&O Policies**

A unique area for FCA Claims coverage litigation is in the context of EPL and D&O Policies. While the vast majority of coverage litigations for FCA Claims evolve

Many EPL Policies incorporate coverage for whistleblower retaliation claims asserted by employees, and one example would be alleged retaliation against a qui tam relator in violation of the False Claims Act statute at §3730(h) which provides in pertinent part:

(h) RELIEF FROM RETALIATORY ACTIONS –

(1) In General – Any employee…shall be entitled to all relief necessary to make that employee…whole, if that employee…is discharged, demoted, suspended, threatened, harassed, or in any other manner discriminated against in the terms and conditions of employment because of lawful acts done by the employee…on behalf of the employee, contractor, or agent or associated others in furtherance of other efforts to stop 1 or more violations of this subchapter.

(2) Relief – Relief under paragraph (1) shall include reinstatement…2 times the amount of back pay, interest on back pay, and compensation for any special damages sustained as a result of the discrimination, including litigation costs and reasonable attorneys’ fees.

Therefore, a retaliation claim asserted under the FCA is one of the types of retaliation claims that potentially would be covered under an EPL Policy provided that retaliation is a type of defined covered Wrongful Employment Act in the EPL wording. See, Community Health, 2012 WL 713305 at 4; Essai, 12-7208 slip op. at 3 (defining Wrongful Employment Act to include “illegal retaliatory treatment of employees”). In contrast following the reasoning of Horizon West and the numerous professional liability cases discussed supra, the FCA causes of action brought under §3729 are not premised on treatment of employees but rather on presentation of false claims for payment to the U.S. Government, thus, such causes of action should not be afforded coverage under EPL Policies. On the D&O side, policy wording on the insuring agreement will reflect coverage for “Wrongful Acts”, as contrasted with coverage for specific professional services in E&O Policies or specific employment-related acts in EPL Policies. See, HR Acquisition I Corp., 547 F.3d at 1311.

D&O and EPL Policies are almost always “Claims Made” policies, and determination of the date the FCA Claim was first made, and whether the FCA Claim is interrelated with any prior Claim(s) is a crucial inquiry. To date, the case law has been sparse on these threshold coverage issues for EPL and D&O, with reasoning by the Courts that appears to be somewhat outcome-driven. In the case of Carolina Cas. Ins. Co. v. Omeros, 2013 WL 5530588 at 3-4, the CFO of the Insured brought a retaliation Claim in April of 2009 for allegedly being unlawfully terminated for disclosing that the Insured gave inaccurate audit reports on use of grant money from the National Institutes of Health. Id. at 1. The plaintiff later filed a qui tam suit, which was not noticed until after expiration of the combined D&O and EPL policies issued to Omeros. Id. at 3. The Court rejected arguments from the insurer that the employee retaliation and government FCA counts were not related, and that the two litigations, one qui tam and one employment retaliation, constituted distinct causes of action, seeking different types of relief, for different parties - an employee on the one hand and the government on the other. Id. The Court did not find the cases distinct for purposes of finding interrelatedness, and held that the insurer must defend. Id. at 4. In seeming disconnect, however, the Court simultaneously ruled that the qui tam suit was not excluded by the D&O Policy exclusion for any Claim “…in any way involving…an employment relationship” which was the insurer’s alternative argument. Id. at 5. The Court concluded that the retaliation and qui tam FCA Claims could be deemed related under the single-claim provision, but not related under the employment relationship exclusion. Id.

Contrast the Omeros holding with the determination by the Court on interrelatedness between FCA retaliation charge and an FCA Claim in Community Health, 2012 WL 713305 at 3. In Community Health, the Court was faced with an early Retaliation Charge that was never noticed to the insurer, and a subsequent unsealed and amended qui tam case several years later. Id. The Court ruled that only the retaliation portions of the two litigations were interrelated under the Policy wording,
and that the *qui tam* could be covered under a later year policy. *Id.* at 4-5.

While the *Omeros* and *Community Health* cases both addressed date of Claim and interrelatedness under combined form D&O and EPL policies which offered both types of insurance coverage, the July 1, 2014 Order in *Eisai*, 12-cv-07208 slip op. at 2, addresses coverage for an FCA Claim under a policy that insures only Wrongful Employment Acts as defined. Like the other cases, an early retaliation case was filed in Florida by a relator, and defended and settled with partial funding by Zurich. *Id.* at 4. A sealed *qui tam* action was filed at the same time as the retaliation Claim, and years later it was unsealed, served on Eisai, and noticed to Zurich long after the policy had expired. Zurich sought a ruling that the EPL Policy did not respond to FCA Claims asserted in the *qui tam* litigation for recovery of government funds because such matters were not for Wrongful Employment Acts, but the Court rejected Zurich’s argument and rejected the reasoning in all the lines of cases distinguishing FCA Claims from the underlying conduct alleged in the pleading. *Id.* at 16. The Court in *Eisai* listed all of the employment allegations in the FCA Claim about the company’s failure to properly supervise its sales staff such that the false claims were presented to the government. *Id.* at 17. The *Eisai* Court, in drawing distinctions to so many precedential cases before the Order, notes that the distinction is warranted because the Policy definition of Wrongful Employment Act is governed by the phrase “in connection with” rather than phrases in the *Momenes* line of cases such as “because of.” Unlike *Omeros* and *Community Health*, the Court finds that the FCA Claims are Wrongful Employment Practices as defined, and does not go on to assess the additional threshold issue of whether the Claim was timely first made and reported. *Id.* at 24. The case may be subject to a re-argument motion or appeal, as it was only very recently decided.

**Policy Exclusions and Limitations**

Numerous coverage litigations focus on potentially applicable exclusions or limitations for *qui tam* claims under the FCA. The fraud and dishonesty exclusion is often found to be a complete bar to coverage for FCA Claims due to the fact that such Claims require proof of knowing submission of false information to the United States Government. *See, e.g., Genstar, 2014 WL 479759 at 6* (holding that an exclusion for dishonest or fraudulent acts committed by, at the direction of, or with knowledge of any Insured would bar coverage for an FCA Claim); *MSO Washington, 2013 WL 1914482 at 9* (Liability under the FCA involves dishonesty and RSUI has no duty to defend or indemnify the FCA Claim per the Dishonesty Exclusion in the Policy), *contrast, Huron Consulting, 2014 WL 1997170 at 2* (fraud exclusion requiring adjudication or conviction does not bar defense coverage for FCA Claim at the outset).

As noted above, an FCA Claim brought by a relator must first be filed under seal for a minimum of 60 days and not served on the defendants. *See, 31 U.S.C. §3730(b)(4)*. Courts have found that the mere filing of the sealed *qui tam* complaint in a court is enough to deem the lawsuit “pending” for the purpose of prior and pending litigation exclusions. *See, e.g., AmerisourceBergen, 2013 WL 3868784 at 4, 7* (date that *qui tam* suit filed under seal is operative date for prior and pending litigation exclusion); *HR Acquisition, 547 F.3d at 1314* (same). The case of *Huron Consulting, 2014 WL 1997170 at 9*, holds that an exclusion for regulatory proceedings does not apply to an FCA Claim. Likewise, in *AmerisourceBergen, 2013 WL 3868784 at 9*, the Court holds that a consumer protection exclusion does not apply to an FCA Claim about inflated drug prices sold to Medicare and Medicaid customers, and the same case holds that such allegations also do not trigger a policy exclusion for Claims “alleging, based upon, arising out of or attributable to inaccurate or inadequate description of the price of goods...” *Id.* at 10.

The Court in *AmerisourceBergen, 2013 WL 3868784 at 8*, does find and hold that an FCA Claim for unfair and falsely inflated drug pricing is excluded by a policy exclusion for “false, deceptive or unfair business practices or any violation of consumer protection laws.” The Court in *AmerisourceBergen, id.*., reasons that the FCA Claim allegations plainly set forth the allegation that defendants conspired to submit false claims for payment by Medicare and Medicaid on the premise of false and deceptive business policies, such that the exclusion bars coverage for the Claim.

Other potentially applicable coverage limitations – which could serve as an entire article topic standing alone - are the various coverage limitations associated with the relief sought in FCA Claims. Coverage may turn on policies’ definitions of “Loss” or “damages”. Notably, most policies bar coverage for any amounts deemed uninsurable under the law. Insurability of the relief sought in an FCA Claim, depending on the jurisdiction, likely will operate to limit coverage for any disgorgement, restitution or return of ill-gotten funds at the heart of damages in an FCA Claim. In most policy
forms, the per violation civil penalties set forth in the False Claims Act would not be considered a covered part of “Loss” by policy definition, nor would they be considered damages. The same is true for the multiplied portion of multiplied damages in certain jurisdictions. Lastly, payment of plaintiffs’ attorneys fees’ may or may not be covered depending on the circumstances and reason for the award, and which aspect of the Claim, retaliation or qui tam, to which such fees are tied. Lastly, if an insurer defends and later wins a declaratory judgment of no duty to defend, certain jurisdictions and certain policy wordings will allow the insurer recoup fees from the Insureds on the basis of unjust enrichment or contractual or statutory right to recoupment.

**Conclusion**

In the past year, several FCA insurance coverage matters have generated rulings based on interrelatedness and date of claim that tend to focus on whether the employment aspect of the FCA and billing recovery aspect of the FCA can be deemed interrelated. These newer cases have distinguished a reasonably developed line of precedent demarcating the FCA Claim for return of fees from underlying predicate conduct. Further litigation and review may be needed to settle back at a more consistent approach on how the FCA and retaliation claims work under professional and management lines policies. Moreover, given the high amounts of money at stake in FCA matters, we expect continuing coverage litigation where there is any question on coverage, interrelatedness, Loss limitations or date of Claim, as both insureds and insurers will be eager to press what each perceive as strong coverage positions when in the face of such high exposure disputes.
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exclusively in the state or federal courts of the State of New York, Suffolk County, and, as such, the Court agreed that it had personal jurisdiction over him. 4 While Stonebranch is a Georgia company with a principal place of business in Alpharetta, Georgia, and was not a signatory to the employment agreement, CA argued that the exercise of New York’s personal jurisdiction over Stonebranch would be proper, as well, because Stonebranch was “closely related” to the dispute giving rise to the claim. And while it seems somewhat illogical to think a corporation could be found to have essentially consented to personal jurisdiction over it via a document it had not signed, the argument was not as far-fetched as one might initially presume.

Under the “closely related” test, courts consider whether the non-signatory is “so closely related to the dispute that it becomes foreseeable that it will be bound.” 5 In applying the test, the court in this case noted that a party’s non-signatory status does not preclude enforcement of the forum selection clause against the party. 6 However, the foreseeability requirement “implies that the non-signatory must have been otherwise involved in the transaction in some manner.” 7

After Stonebranch moved to dismiss for lack of personal jurisdiction, the Court rejected the argument that Stonebranch could be held subject to the Court’s in personam jurisdiction under the terms of the employee’s contract in this instance. In doing so, the Court concluded that Stonebranch was not sufficiently “closely related” to either the employee or the dispute so that enforcement of the forum selection clause was foreseeable because: (1) there was no relation, affiliation or connection between the employee and Stonebranch when the employee entered into the employment agreement with CA or six years later when the employee left CA and Stonebranch hired him; (2) Stonebranch apparently became aware of the forum selection clause and restrictive covenant only after it hired the employee and, as such, the clause was not “reasonably communicated” to Stonebranch such that it should have reasonably foreseen that it would be sued in New York for hiring the employee; and (3) Stonebranch had no interest in or involvement with the negotiation of the agreement or the establishment of the employment relationship between the signatories. 8 In discussing the latter point, the Court noted that “[t]he vast majority of cases that have found a non-signatory bound by a forum selection clause under the theory that they are ‘closely related’ to the dispute or the signatory, have done so where the non-signatory had a far more active role in the transaction.” 9

While it is believed the district court reached the correct conclusion in the CA, Inc. case, one aspect of the decision that may be of concern for employers hiring a new employee is the reliance it placed on the question of the new employer’s apparent lack of knowledge of the forum selection clause until after it hired the employee. This suggests the possibility that where an employer hires an employee with knowledge of the restrictive covenants and forum selection clause in his/her employment agreement, the new employer may be deemed to be bound by the forum selection clause - - and may also potentially be deemed subject to the court’s in personam jurisdiction as a result - - even though it did not also sign the agreement, and even though it would not be subject to the court’s in personam jurisdiction otherwise. In issuing its ruling on this issue, the Court made note of a case from the District of Kansas, Central Transp. Servs., Inc. v. Cole. 10 In that case, the court similarly declined to subject a new employer to the forum selection provisions of the employees’ contract with their employer, specifically noting that there could not be a finding that the new employer was “closely related” to the employees or the dispute because it had hired the employees at issue without knowledge of the non-compete provision and forum selection clause in the employees’ agreements, and only learned of the provisions a few days later. The implication is that, had there been evidence that the new employer knew of the forum selection provisions of the new employee’s employment agreement prior to his/her hiring, the result might have been different.

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5 Id. at *18.
6 Id.
With the exception of the CA, Inc. case, there appears to be no other case in the Second Circuit addressing the enforcement of a forum selection clause in an employment agreement against a non-signatory future employer with no interest or involvement in negotiation of the employment agreement at issue, or the establishment of the employment relationship between the signatories. And, the more general question of whether a signatory may enforce a forum selection clause against a non-signatory under the ‘closely related’ doctrine, particularly a non-signatory future employer, remains an open question in the Second Circuit Court of Appeals as well.11

Addressing the flip side of the coin, the Second Circuit has recently held that:

a non-signatory to a contract containing a forum selection clause may enforce the forum selection clause against a signatory when the non-signatory is “closely related” to another signatory. In such instances, the relationship between the non-signatory and that (latter) signatory must be sufficiently close that the non-signatory’s enforcement of the forum selection clause is “foreseeable” to the signatory against whom the non-signatory wishes to enforce the forum selection clause. As the signatories to the contract have already assented to a forum selection clause and thus have agreed to litigate disputes relating to the contract in the chosen forum, this holding comports with the ‘legitimate expectations of the parties, manifested in their freely negotiated agreement.’12

However, the Second Circuit made it a point to note that in rendering this decision it was “not reaching the question of when a signatory may enforce a forum selection clause against a non-signatory.”13

The analysis in Magi XXI, is instructive, nonetheless. Reviewing the analysis presented in Magi XXI, it can be seen that the Second Circuit drew a clear distinction between: (1) cases wherein a non-signatory, who is closely related to a signatory, seeks to enforce a forum selection clause against another signatory; and (2) cases wherein a signatory seeks to enforce a forum selection clause against a non-signatory.

With respect to the first category of cases, the Second Circuit has held that a forum selection clause encompasses claims made by a non-signatory against a signatory as long as: (1) those claims are “nearly identical to” the claims against the signatory; (2) the claims “arise out of” the same transaction; and (3) the non-signatory consents to the foreign jurisdiction.14 Bearing this in mind, it would appear that the non-signatory defendant’s consent to a forum selection clause is the critical factor. The question is: applying this logic in cases which do not involve affirmative efforts by the non-signatory to seek to litigate in the jurisdiction designated in the forum selection clause, how is a court to identify and confirm the existence of such consent?

Although District Court cases have enforced a forum selection clause against non-signatories, they have generally done so in very limited contexts, such as where the non-signatory was a successor-in-interest to the signatory, a third party beneficiary of the agreement, involved in the contract negotiations, or an agent of the signatory (as in the case of an agent, officer or director of a corporation who signs on behalf of the corporation or is involved in the transaction that is the subject of

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11 The Second Circuit has previously held outside the context of the closely related test that “if successorship is established, a non-signatory is subject to the M/S Bremen presumption of the enforceability of mandatory forum selection clauses.” Agua Lenders Recovery Group, LLC v. Steer, S.A., 585 F.3d 696, 701 (2d Cir. 2009) (citing MS Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 12, 92 S.Ct. 1907, 1914, 32 L.Ed.2d 513 (1972)). Notably, in reaching its holding in Agua, the Second Circuit reasoned that because “[s]uccessorship doctrine prevents parties to contracts from using evasive, formalistic means lacking economic substance to escape contractual obligations” there was “no reason to treat forum selection clauses differently from other contractual obligations.”

12 Magi XXI, Inc. v. Stato della Città del Vaticano, 714 F.3d 714 (2d Cir. 2013) (emphasis added).

13 Magi XXI, supra, 714 F.3d 723, n. 10. See also Shea Dev. Corp. v. Watson, 07 Civ. 11201 (DLC), 2008 U.S. Dist. LEXIS 22680, *6-8, 2008 WL 762087 (S.D.N.Y. Mar. 24, 2008) (noting that the Second Circuit had not yet adopted the framework of the closely related doctrine with respect to forum selection clauses and distinguishing cases); Mazuma Holding Corp. v. Bethke, 2014 U.S. Dist. LEXIS 20990, 35-37, 2014 WL 814066 (E.D.N.Y. Mar. 3, 2014) (noting the Second Circuit has not reached the question of “when” a signatory may enforce a forum selection clause against another signatory). Further, the Second Circuit noted as well that it was not disturbing its holding in Smoothline Ltd. v. North American Foreign Trading Corp., 249 F.3d 127, 138 & n.4 (2d Cir. 2001), that the “closely related” test does not apply to the question of whether a non-signatory is bound by a mandatory arbitration clause; in such cases a non-signatory can only be bound under theories of: (1) incorporation by reference; (2) assumption; (3) agency; (4) veil-piercing alter ego; and (5) estoppel. Magi XXI, supra, 714 F.3d 723, n. 9.

the agreement or in the agreement itself). considering these cases, it arguably stands to reason that the forum selection clause should not be enforced against a non-signatory who has not assumed the signatories’ liabilities under the agreement as successor-in-interest or otherwise, is not a third party beneficiary of the contract, was not involved in the transaction which is consummated in the agreement, and was not a representative or agent of the signatory. Arguably, there must be something more than the simple act of employing someone who in his prior contract had consented to jurisdiction over him/her.

Indeed, given that the current employer often has not come into the picture until years after the employee signed the agreement with the former employer, there is generally no argument that can be made that the current employer had access to the employee’s employment agreement before the employee signed it. In such circumstances, it cannot be said that the forum selection clause was “reasonably communicated” to the current employer before it was agreed to by the employee. Applying this logic, in Shea Dev. Corp. v. Watson, the court held the non-signatory was not bound by the forum selection clause in the acquisition agreement at issue as it was not reasonably communicated to her. The court noted that there were no allegations that she had access to the agreement at any time before it was signed, or that she played a sufficiently substantial role in the acquisition negotiations such that notice of the agreement’s provisions should be imputed to her. This decision suggests that knowledge of the forum selection clause at the time the agreement was entered into is a critical factor, and thus that hiring an employee after the fact should not, alone, be sufficient to confer jurisdiction over the new employer, even where the new employer has reviewed the employment agreement before extending an offer of employment.

III. How the Issue Has Been Addressed Outside the Second Circuit

Looking at how this issue has been addressed in other contexts, it can be seen that courts in other circuits have enforced a forum selection clause against a new employer, but most of those cases are factually distinguishable from the CA, Inc. case. For example, in East Coast Karate Studios, Inc. v. Lifestyle Marital Arts, a former employer sought to enforce a forum selection clause against not only the former employee, but the former employee’s wife and new employer, neither of whom were signatories to the non-competition agreement at issue. The former employer was a martial arts business that hired the employee subject to a non-compete agreement (with forum selection clause) providing that for two years from the date of termination of his employment he would not engage in the same business within the county or within a twenty-five mile radius of the county. After the employee resigned, he immediately began working within a twenty-five mile radius for a martial arts business where his wife was a managing member. The employee, his wife, and his new employer filed a declaratory judgment action in Palm Beach County, Florida, but the former employer moved to transfer venue of the action from Palm Beach County to Broward County, the forum selected in the agreement. In these circumstances the appellate court found the forum selection clause to be enforceable against the non-signatories, applying the “closely related” test, because the non-signatories were closely related to the employee signatory, the non-signatories’ interests derived from the employee’s interests, and the claims involving the non-signatories directly arose out of the non-competition agreement. However, it should be noted that this case addressed only the question of venue, and did not involve the more delicate question of personal jurisdiction over an out-of-state resident.

15 See e.g., Recurrent, supra, 875 F.Supp.2d at 306 (forum selection clause enforced against non-signatory corporate entity who was deemed the signatory’s successor in interest, and closely related individual shareholder/ officer defendant who had been involved in the agreement’s formation); Metro-Goldwyn-Mayer Studios Inc. v. Canal+ Distr. S.A.S., No. 07 Civ. 3218, 2010 U.S. Dist. LEXIS 17463, 2010 WL 357583 (S.D.N.Y. Feb. 9, 2010) (signatory plaintiff could enforce forum selection clause against non-signatory defendant who was alleged to be successor in interest to other signatory); International Private Satellite Partners, L.P. v. Lucky Cat Limited, 975 F.Supp. 483, 486 (W.D.N.Y. 1997) (non-signatory defendant who purchased assets and customer lists and presumably assumed all contractual obligations bound under closely related theory or under theory of successor liability following defacto merger); American Steamship Owners Mutual Protection and Indemnity Assoc., Inc. v. The American Boat Co., LLC, 11 Civ. 6804(PAE), 2012 U.S. Dist. LEXIS 21739, *13, 2012 WL 5272929 (S.D.N.Y February 17, 2012) (Defendant non-signatory insured was estopped pursuant to the “direct benefits theory” from disclaiming forum selection clause because it claimed benefits, including defense costs and indemnification under the insurance contract containing the forum selection clause); Firefly Equities LLC v. Ultimate Combustion Co., Inc., 736 F.Supp.2d 797, 800 (S.D.N.Y 2010) (individual defendant president accused of inducing plaintiffs to enter into the agreement that was the subject of the MOU and who held 17% of the corporate entity’s outstanding shares and signed on behalf of company was bound by forum selection clause because it was foreseeable “the clause might have application to disputes arising under that agreement that also involved him”); Infinity Consulting Group, LLC v. Am. Cybersystems, Inc., 09-CV-1744(JSJ)(WDW), 2010 U.S. Dist. LEXIS 54116, *6-8, 2010 WL 2267470 (E.D.N.Y. May 30, 2010) (Comptroller who did not sign the agreement was not closely related but president who signed the contract on behalf of the company and was accused of fraudulently inducing the agreement was closely related); Kahala Corp. v. Holtzman, No. 10 Civ. 4259, 2010 U.S. Dist. LEXIS 128161, 2010 WL 4942221 (S.D.N.Y. Dec. 03, 2010) (clause enforceable against individual defendant who signed on behalf of defendant entity and signed personal guarantee section); Nanoprobe Technologies, Inc. v. Southbridge Capital Mgmt. LLC, No. 02 Civ. 767 (LBS), 2003 U.S. Dist. LEXIS 21858 at *17, 2003 WL 22882337 (S.D.N.Y. Dec. 4, 2003) (finding non-signatory to be bound by forum selection clause where the non-signatory was the corporation’s chief financial officer and fraudulently induced plaintiff to enter into the contract).


17 Id.

18 East Coast Karate Studios, Inc. v. Lifestyle Marital Arts, 65 So. 3d 1127, 1128-29 (Fla. 4th DCA 2011).
In *Medtronic Inc. v. Endologix, Inc.*, a forum selection clause was also enforced against a new employer who was not a signatory to two former employee’s employment agreements.¹⁹ The forum selection clauses provided that any disputes arising under the employment agreements had to be brought in a Minnesota state court, and that employees could not assist or participate in any third party’s commencement or prosecution of a related lawsuit in any court other than Minnesota state court. The former employer filed suit in Minnesota state court against the former employees for breach of the non-compete agreements and the new employer for inducing the breaches. After the new employer removed the action to federal court on diversity grounds, the former employer moved to remand, arguing the forum selection clause bound the new employer and employees. The federal court agreed with the former employer and remanded the case to state court because the new employer, who knew of the non-compete covenants prior to hiring the employees, was “closely related to the dispute such that it becomes foreseeable that it will be bound.”²⁰ Again, however, this was not a case involving the more delicate question of personal jurisdiction over a non-resident.

A more problematic case for foreign employers hiring new employees who may be the subject of a lawsuit was issued in the Eastern District of Pennsylvania. In *Synthes, Inc. v. Emerge Med. Inc.*, ²¹ the court enforced a forum selection clause against a non-signatory who moved to dismiss for lack of personal jurisdiction, noting that “courts considering this question of whether a non-signatory may be bound by a forum selection clause take a common sense, totality of the circumstances approach that essentially inquires whether, in light of those circumstances, it is fair and reasonable to bind a non-party to the forum selection clause, [an] approach [which] places emphasis on whether it should have been reasonably foreseeable to the non-signatory that situations might arise in which the non-signatory would become involved in the relevant contract dispute.”²² This case was not against a new employer; instead, the non-signatory defendant was an officer of a competing business founded by the employee signatories. The non-signatory, who was never employed with the plaintiff Synthes, were alleged to have collaborated with employees of Synthes while they were still employed with Synthes to begin a competing business, Emerge, by using Synthes’s confidential information. The non-signatory later became Chief Operating Officer and a director of Emerge. In this instance, the court found that the totality of the circumstances justified enforcing the forum selection clause in the employees’ agreement with their former employer to allow for assertion of personal jurisdiction over the non-signatory because a close business relationship existed between the signatories and non-signatories to the pertinent agreements, and because the dispute among the parties centered on the interpretation of the agreements. Moreover, the non-signatory was alleged to have tortiously interfered with the employees’ contractual relationships with the former employer. In reaching this holding, the court found that “temporal proximity” is not a requirement. In other words, the non-signatory defendants need not have been closely related to the signatory defendant at the time the forum selection clause was signed. Instead, the Court concluded, “[a]ll that is required is facts demonstrating a close relationship to the signatory or to the contractual dispute, such that application of the forum selection clause was reasonably foreseeable.”²³

IV. Conclusion

Pending clarification from the Circuit Courts, the foregoing cases serve as a caution to foreign employers hiring new employees subject to a non-compete agreement with an unfavorable forum selection clause. And they arguably may create something of a quandary as well. On the one hand, it is important - in making an informed decision as to whether to hire an employee, and how to avoid potential litigation – for the new employer to review the prospective new employee’s employment contract. On the other hand, having knowledge of a forum selection clause in the prospective employee’s employment agreement prior to hiring him may arguably provide grounds for the former employer to seek to subject the new employer to personal jurisdiction in a jurisdiction where it would otherwise not be subject to same. Alternatively, even if personal jurisdiction over the new employer is not in issue, venue may be in dispute, yet the new employer may find itself litigating in the forum selected by its adversary years before the dispute had even arisen, per the terms of a contract the new employer never signed. ²⁴

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²⁰ Id. at 1056, 1958-59.
²² Id. at 607-608.
²³ Id. at 613.
## 2014 - 2015 TIPS CALENDAR

**August 2014**
- **4** Member’s Monday  
  Contact: Ninah F. Moore – 312/988-5498
- **7-12** ABA Annual Meeting  
  Contact: Felisha A. Stewart – 312/988-5672  
  Speaker Contact: Donald Quarles – 312/988-5708

**October 2014**
- **6** Member’s Monday  
  Contact: Ninah F. Moore – 312/988-5498
- **15-19** TIPS Section Fall Leadership Meeting  
  Contact: Felisha A. Stewart – 312/988-5672  
  Speaker Contact: Donald Quarles – 312/988-5708

**November 2014**
- **5-7** FSLC & FLA Fall Meeting  
  Contact: Donald Quarles – 312/988-5708

**December 2014**
- **8** Member’s Monday  
  Contact: Ninah F. Moore – 312/988-5498

**January 2015**
- **15-17** LHPR Midwinter Symposium  
  Contact: Ninah F. Moore – 312/988-5498
- **21-23** Fidelity & Surety Committee Midwinter Mtg  
  Contact: Felisha A. Stewart – 312/988-5672

**February 2015**
- **5-8** ABA Midyear Meeting  
  Contact: Felisha A. Stewart – 312/988-5672